

EXECUTIVE CHAMBERS
State Capitol
Honolulu, Hawaii 96813

**GOVERNOR'S MESSAGE
TO THE 23RD STATE LEGISLATURE OF HAWAII
MEETING IN THE REGULAR SESSION OF 2006**

Today, I am submitting to the State Legislature a FY 2007 Supplemental Budget and Financial Plan that encourages investment in the future of Hawaii, addresses the deferred maintenance of public facilities, and eases the high cost of living on our residents.

This Budget and Financial Plan is fundamentally different from those I have proposed in previous budget cycles. First, it proposes major new capital improvement investments in the physical plant of our State. Second, it balances targeted expenditures with significant tax relief. And, third, it allows us to put aside funds for a rainy day. It is gratifying to know that we have arrived at a point where all of this is possible due to the State's significantly improved financial condition.

Specifically I am proposing an additional \$528.5 million in operating expenditures and \$926.6 million in capital improvements for FY 2007. (Of these increases, the request for general funds is \$239 million for operations and \$265 million in general obligation (G.O.) bonds for capital improvement projects). These proposed increases would be added to the \$9.1 billion in operating expenses and \$664 million in capital improvements previously approved by the Legislature for this coming fiscal year.

THE ECONOMY

Calendar year 2005 will register as one of the best years ever for Hawaii's economy. Throughout the first three quarters, Hawaii's economic performance continued to exceed expectations and projections. The current solid rates of growth in employment, personal income, and tax collections are indicative of the continuing broad-based expansion of the local economy.

As a result of impressive gains in job growth, Hawaii's unemployment rate decreased to 2.7% and earned the distinction of being the lowest in the nation. Total personal income grew at a solid rate of 8.2% in the first half of 2005, or 4.9% when adjusted for inflation. General fund tax revenues rose by 16.5 % in the first 11 months, reflecting real gains in the economy. This economic expansion occurred in all key sectors: tourism, construction, real estate, and federal military expenditures.

While we can take comfort in the recent robust performance of Hawaii's economy, the challenge we now face is maintaining this momentum so that opportunities continue to be available to all of our residents, while preserving the unique qualities of life that distinguish our State. Toward this goal, I established the Economic Momentum Commission in June 2005 to develop an action plan to sustain the State's current economic momentum, while avoiding the

boom and bust cycles that have occurred historically. With bipartisan support from the Hawaii State Legislature and membership from diverse organizations in our community, the Commission focused on finding practical ideas that will help sustain recent achievements. The Commission has developed a thoughtful list of recommendations for action that can be accomplished over the next six years to sustain the economic growth that will be necessary to improve Hawaii's quality of life. These ideas merit your consideration during this legislative session.

FY 2005 began with a carry-over balance of \$184.6 million in the General Fund and ended with a \$486.4 million balance on June 30, 2005. This improvement is a hard-earned dividend from our prudent fiscal management during the previous three years. The State's improved financial condition was also brought about by the solid recovery of the economy.

REVENUE PROJECTIONS

At its most recent meeting on September 2, 2005, the Council on Revenues (COR) projected general fund revenues to the State will grow by 6.0% in FY 2006 and by 6.6% in FY 2007. Revenue growth for the four out-years (2008-2011) was forecast to be in the range of 4.9% to 7.3%. These projections show that the COR expected a certain amount of moderation in the economy starting with FY 2006. While this cautious view is prudent, the actual numbers seem to tell a more upbeat story.

Actual general fund tax collections rose by 13.7 % in the first five months of FY 2006, and the growth occurred across the board in all major tax categories, including income, general excise, and transient accommodations. This revenue growth is more than twice the annual rate of growth projected by the COR. Underlying this strong performance in actual revenues were two factors: higher

personal income and a substantial rise in corporate income tax collections. In November 2005, with more current data from the U.S. Bureau of Economic Analysis, the COR revised its forecast of Hawaii's growth in 2005 total personal income from 7.3% to 8.2%.

At the higher level of personal income, and with additional corporate income tax collections, we now expect general fund tax revenues to grow by 7.9 % in FY 2006 and by 6.3 % in FY 2007. These new projections by my Administration represent an increase of \$73.9 million in FY 2006 and \$69.1 million in FY 2007 when compared to the September estimates of the COR.

As a result, we project that the carry-over balance from FY 2006 into the new fiscal year will be \$570.0 million. We further project that FY 2007 tax revenues will total \$4,584.5 million. The combination of these amounts (\$5,154.5 million) allows us to propose a Supplemental Budget and Financial Plan that takes a balanced, measured, and comprehensive approach to addressing current community needs.

THE PROGRAM AGENDA

State departments and programs have had to operate under stringent conditions for many years when the economy was performing poorly and general fund revenues were inadequate to meet community needs. With easing financial constraints, we can now address these public funding issues in a fiscally positive environment.

As indicated above, I am recommending a total of \$528.5 million in additional operating expenditures and \$926.6 million in additional capital improvements in the coming fiscal year. The proposed expenditures renew and increase our commitment to public education, invest in workforce development, bolster our support for

health and human services to those most in need, protect and preserve our natural and cultural resources, increase the carrying capacity of our transportation systems and rebuild our infrastructure including our public housing.

Education

I am requesting an additional \$138.8 million for the State's public education system (\$82.5 million in operating funds and \$56.3 million for capital improvements). This sum includes \$63.2 million in additional funds for school repairs and maintenance, of which \$40 million will be cash that can be used immediately to repair deteriorating classrooms.

The amount of \$19.6 million is being requested to build specific facilities on Oahu and Lanai at schools that are overcrowded or old.

A total of \$17.4 million will be added for special education services to preschool children and K-12 students to serve a growing number of children with special needs. \$17.9 million for operating and facilities costs will be provided to existing and new charter schools to foster alternative learning centers on all islands. \$8.4 million will cover the added costs of transporting students to schools, and \$4.8 million will allow expansion of the Makawao Public Library.

Finally, I want to highlight the addition of \$1.2 million to expand educational opportunities for children who speak English as a second language. It is critically important that we recognize the significance of giving language tools to non-English speakers so they can live and work effectively in their new surroundings.

University of Hawaii and Workforce Development

The FY 2007 Supplemental Budget Request increases by \$45.6 million in operating funds to the University of Hawaii (UH) and recommends an additional \$251.6 million for facility improvements.

Within these totals, this Supplemental Budget commits \$33.6 million in funds for the design and construction of the first increment of the infrastructure necessary to build UH West Oahu. This investment will attract an estimated \$175 million in private funds for the campus build-out. An additional \$43 million in Capital Improvement Program (CIP) monies and \$10 million in cash are being proposed for repair and maintenance (R&M) of other University facilities statewide.

In addition to this commitment to reconstruct and expand the UH campuses, the proposed Supplemental Budget includes \$45.6 million in operating funds to expand Hawaiian Studies programs, increase security at various campuses, continue our investment in the new College of Pharmacy in Hilo, support accreditation activities at the community colleges, and cover ongoing operations.

Incorporated in the proposed operating fund increases noted above is a commitment to augment workforce development spending by \$11.7 million. These monies will be utilized to expand the number of nurses that can be accepted into the School of Nursing, increase the number of certified teachers produced by the College of Education, and significantly expand the Construction Academy that helps high school students prepare for entry into the building trades.

Health and Human Services

The FY 2007 Supplemental Budget Request adds \$87.5 million in operating funds to the Department of Human Services.

\$42.9 million of this amount is requested to cover higher Medicaid costs incurred in FY 2006 and to accommodate an expected increase in rates and enrollment in FY 2007.

The sum of \$23 million is recommended to update the Medicaid fee schedule to fund higher reimbursements to medical service providers, helping to ensure adequate medical services remain available to low income individuals who are sick or frail.

I am proposing \$7.6 million to restore dental coverage to adults in the Medicaid fee-for-service and QUEST health insurance programs. These funds will be used to provide basic preventive care such as dental exams, teeth cleanings, and x-rays. This is the first time adults will be able to obtain these services since they were eliminated in 1996.

Also included in the proposed Supplemental Budget increase is \$12.2 million to expand Medicaid coverage for the uninsured and for direct payments to private hospitals that treat these patients. It is estimated an additional 2,500 individuals will be able to enroll in QUEST if this increase is approved by the Legislature. This is part of my Administration's ongoing commitment to provide medical coverage to all those who need it.

The Department of Health requests a total of \$103.1 million (\$85.7 million in operating and \$17.4 million in capital improvement funds). A critical component includes \$56.6 million in federal and State funds to provide community based services for developmentally disabled individuals as required by the Makin II

legal settlement. \$10.4 million is targeted for increased costs in medical services and \$13.8 million will be used for physical improvements and equipment in State hospitals and health centers. The balance will pay for clinical services to adolescent mental health clients, adult mental health programs, and expansion of primary care services.

The Environment

The Supplemental Budget Request adds \$124.8 million (\$82.8 million in operating funds and \$42 million in G.O. bonds) to preserve and protect our natural and cultural assets on every island. The sum of \$28.7 million is being requested to support county projects to improve drinking water systems. Another \$38 million will be added for wastewater treatment/water pollution control. \$10 million is being allocated to the Waimanalo Wastewater Treatment Plant to complete the upgrade of that facility so that it can operate at its planned capacity and avoid future near-shore water pollution. The amount of \$12 million is identified for North Kona Water system improvements.

We are recommending \$10.5 million for improvements in State parks including regular power washing of restrooms. An additional \$10 million is suggested for much-needed improvements to the small boat harbors docks and facilities. And \$14.1 million is requested for Natural Area Reserves, land conservation, and the establishment of Environmental Education Centers statewide.

Transportation

The time has finally come when we can begin to repair the deteriorating infrastructure of our State, modernizing, improving and increasing its carrying capacity. I am proposing an addition of

\$482.8 million (\$20.3 million in operating funds and \$462.5 million in CIP funds) for our State harbors, airports, and highways.

Specifically, I am requesting \$306.8 million for airport initiatives, of which \$195.2 million in revenue bonds and federal funds would be used to begin major renovations at Honolulu International Airport.

I am recommending \$134.8 million more for highway construction this coming year including an additional \$86 million for the North/South Road on Oahu and \$19 million for improvements to Kuhio Highway on Kauai. These additional funds will add to the \$231.3 million already approved by the Legislature for highway improvements in FY 2007.

Third, I am seeking an additional \$20.9 million for harbor upgrades including pier repairs and additions in Kahului, Maui and Nawiliwili, Kauai and improvements to the Kapalama Container Terminal in Honolulu.

Other Investments

In addition to the monies proposed for Harbors, Highways, and Airports, this Supplemental Budget Request includes \$41.2 million to continue the investment in public and affordable housing projects we launched in 2005. We are asking that \$15 million more be authorized for expenditure from the Rental Housing Trust Fund and \$26.2 million is proposed for reconstruction of public housing facilities, including ensuring that existing units are made ready for needy families.

Earlier this month I announced a series of proposals to ensure that Hawaii remains the State that is best prepared to deal with an emergency, be it a natural or man-made disaster. Incorporated

within this proposed Supplemental Budget is \$4 million in bonds for the retrofit of public buildings, \$2.1 million in bonds for completion of the civil defense communications network, and a \$50 million increase in the federal funds ceiling from Homeland Security.

Finally, it should be mentioned that this proposed Supplemental Budget allots \$10 million to initiate repairs to correctional buildings, fencing, and grounds, and \$2 million to the Hawaii Convention Center to ensure the public's investment in that facility is protected and the Center can continue to attract world class conventions and exhibitions.

Tax Relief to Hawaii Residents

In addition to the spending proposals summarized above, this Supplemental Budget and Financial Plan recognizes that a significant portion of the extra tax monies coming into State coffers should be returned to our citizens, particularly those who struggle most with the high cost of living in Hawaii. This is, in effect, a dividend payment to our residents who have made this economic recovery possible. Substantial tax relief will be proposed through a series of legislative initiatives that will be presented to the Legislature and the public next month.

Strengthening the Emergency and Budget Reserve Fund

Finally, I am proposing to double the size of the Emergency and Budget Reserve Fund, also known as the Rainy Day fund, to a total of \$110 million at the beginning of FY 2007. As most families know, it is important to put aside some funds when times are good because we all experience set-backs or unexpected crises. The State is no different.

The National Association of State Budget Officers has consistently recommended that a reserve of 5% of revenues be maintained to safeguard against budget instability due to unforeseeable circumstances. For Hawaii, this would mean setting aside over \$200 million. This is the time to move toward that well-respected goal. Aside from the benefit of increasing our cushion for future emergencies, such a commitment will have a positive effect on maintaining the State's strong credit rating.

THE GENERAL FUND FINANCIAL PLAN

Next month my Administration will submit legislative proposals for your consideration, including measures that will have a financial impact. Taking into account the requests contained in this Executive Supplemental Budget and the fiscal impact of legislative proposals to be submitted, including emergency appropriations in FY 2006, the ending balance in the General Fund is projected to be \$76.6 million in FY 2007. The Six-Year General Fund Financial Plan shows a positive balance for each year in the 2006-2011 period.

I am proud of the fact that this proposed budget is able to achieve the spending priorities outlined above, provide much-needed tax relief, set aside funds for a rainy day and still have a respectable balance at the end of each year for the next six years.

The State's disciplined approach to managing its budget has been favorably recognized by all three major credit rating agencies. In May 2005, Moody's Investor Service upgraded the State of Hawaii's rating from Aa3 to Aa2; Standard & Poor's Rating Service upgraded Hawaii's outlook from stable to positive at the AA- level; and Fitch Ratings also maintained an AA- for Hawaii.

Like the bond rating agencies, I am optimistic about our State's future and confident that by working together we can continue investing in projects and programs to sustain our economic recovery, protect our natural and cultural resources, and provide the kind of significant tax relief to help our residents deal with the high cost of living.

I respectfully ask for your favorable consideration of the recommendations presented herein and look forward to working with you in the upcoming session to bring forth a Supplemental Budget that is fiscally prudent and forward looking to meet the substantial needs of our community.

Sincerely,

LINDA LINGLE
Governor of Hawaii

APPENDIX TO THE GOVERNOR'S MESSAGE

A. THE EXECUTIVE SUPPLEMENTAL BUDGET RECOMMENDATIONS

THE OPERATING BUDGET

All Funds

For **FY 2006**, adjustments to the budget will be proposed through emergency appropriation measures to address shortfalls in the following areas:

- General Assistance program
- Developmental Disabilities program
- Emergency medical services
- Risk management
- Electricity in schools and public buildings
- Student transportation

Emergency appropriations will also be requested for:

- Hawaii Youth Correctional Facility compliance improvements
- Pandemic flu preparedness
- Financing the DNA Registry Special Fund
- Healthy Start home visiting services

For **FY 2007**, total proposed adjustments to the operating budget amount to a net increase of \$528.5 million, or 5.8%, from all means of financing, as shown below.

Means of <u>Financing</u>	FY 07 Act 178/2005 <u>Appropriation</u> (\$)	FY 07 Proposed <u>Adjustment</u> (\$)	FY 07 Recommended <u>Appropriation</u> (\$)
General Funds	4,523,692,075	238,957,902	4,762,649,977
Special Funds	1,680,737,405	34,434,896	1,715,172,301
Federal Funds	1,521,909,020	121,322,463	1,643,231,483
Private Contributions	122,500	28,469	150,969
County Funds	200,000	700,000	900,000
Trust Funds	51,651,013	3,720,467	55,381,480
Interdept. Transfers	931,934,392	54,570,519	986,504,911
Revolving Funds	358,055,151	74,751,650	432,816,801
Other Funds	<u>8,821,841</u>	<u>.....</u>	<u>8,821,841</u>
Total	9,077,143,397	528,485,366	9,605,629,763

The distribution by department is presented on page 56. Highlights of the Operating Supplemental Budget Request by department are presented in the sections that follow.

General Fund

For **FY 2007**, total proposed general fund adjustments to the operating budget amount to a net increase of \$239 million, or 5.3%, over the current appropriation level. The distribution by department is presented on page 58.

The recommended adjustments are necessary to cover increases in non-discretionary expenses as well as to fund the program initiatives discussed earlier.

Increase in Positions

The Supplemental Budget Request includes an increase in the number of positions for FY 2007, in part due to the new requirement to recognize previously untallied but funded positions within various State agencies.

	<u>Temporary</u>	<u>Permanent</u>
Total additional positions	244.87	553.45
By means of financing:		
General Funds	20.55	482.95
Special Funds	18.50	36.00
Federal Funds	77.82	4.50
Trust Funds	32.00	0.00
Revolving Funds	56.00	16.00
Interdepartmental Transfers	30.00	14.00
Other Funds	10.00	0.00

The increases in positions are for the following:

- The largest increase is for the UH system. A total of 367 permanent positions are requested, of which 32 represent restoration of positions previously abolished. The additional positions are provided to significantly expand work force development programs to meet Hawaii's demands for teachers, nurses, pharmacists and construction trades workers. Positions are also provided to expand the Hawaiian Studies program and

to improve campus security. Various other positions are provided to meet administrative and facility maintenance support needs, enrollment expansion, accreditation requirements, and Title IX compliance.

- The next largest increase reflects the inclusion of previously unbudgeted positions pursuant to Section 167 of the General Appropriations Act of 2005, which prohibits expenditure of funds for positions that are not budgeted. A total of 29 permanent and 249 temporary positions are included to provide legal and investigative services to State agencies, operate the Correctional Industries program, staff the Kahoolawe Island Reserve Commission, service members of the Employees Retirement System, process Unclaimed Property claims, deliver child welfare services, and provide speech language pathology services for special education students.
- The third area of increase is for public schools. A net total of 34 permanent and 12 temporary positions are provided for teachers and educational assistants for special education preschools, teachers of English for second language learners, and teachers for the Hawaiian language immersion program.
- The other area of increase is for the corrections program. 38 permanent positions are provided to improve mental health services at the Oahu Community Correctional Center and to assist in managing inmates housed in mainland facilities and the Federal Detention Center.

THE CAPITAL IMPROVEMENT BUDGET

For FY 2007, total proposed adjustments amount to \$926.6 million, to be funded from the following sources:

Means of <u>Financing</u>	FY 07 <u>Act 178/2005</u> <u>Appropriation</u> (\$)	FY 07 <u>Proposed</u> <u>Adjustment</u> (\$)	FY 07 <u>Recommended</u> <u>Appropriation</u> (\$)
General Funds	.....	.....	.....
Special Funds	137,134,000	182,910,000	320,044,000
G.O. Bonds	162,869,000	254,314,000	417,183,000
G.O. Reimbursable	20,000,000	10,700,000	30,700,000
Revenue Bonds	97,031,000	192,222,000	289,253,000
Federal Funds	244,081,000	158,132,000	402,213,000
Private Contributions	3,000,000	.....	3,000,000
County Funds	.....	2,125,000	2,125,000
Interdept. Transfers	.....	460,000	460,000
Revolving Funds	.....	.....	.....
Other Funds	.....	<u>125,702,000</u>	<u>125,702,000</u>
Total	664,115,000	926,565,000	1,590,680,000

The distribution by department is presented on page 62.

The CIP requests represent the investment the State will need to make in its K-12 and university education systems as well as its capital assets and infrastructure to support the economic base and to maintain the health, safety, and quality of life in Hawaii.

Highlights of the CIP program by department are presented in the sections that follow.

B. REVENUE PROJECTIONS

The proposed General Fund Financial Plan for Fiscal Biennium 2005-2007 and the planning period 2007-2011 uses revenue estimates that differ from projections prepared by the Council on Revenues (COR). Based on more current data regarding total personal income and tax collections, the revised estimates by the Administration represent an increase of \$73.9 million in FY 2006 and \$69.1 million in FY 2007 when compared to the September forecast of the COR.

The notification of use of revenue projections that differ from projections prepared by the COR is presented on page 27 of this document.

C. THE GENERAL FUND EXPENDITURE CEILING

By law, general fund appropriations must comply with the expenditure ceiling requirements that are set forth in Section 9, Article VII of the Hawaii State Constitution and Section 37-92 of the Hawaii Revised Statutes.

At the aggregate level, including all branches of government, total proposed appropriations from the General Fund are within the expenditure ceilings for both FY 2006 and FY 2007.

For the Executive Branch, total proposed appropriations from the General Fund (which include the Executive Supplemental Budget for FB 2005-07 and other specific appropriation measures to be submitted) exceed the appropriation ceiling by another \$48.2 million (or 1.1 %) in FY 2006 and by \$103.6 million (or 2.1 %) in FY 2007. The reasons for these excesses are due to the substantial costs of mandated services, social assistance

entitlements, support for public education, major repairs and maintenance needs statewide, and other critical requirements identified in previous sections.

A summary statement on the General Fund expenditure ceiling and Executive Branch appropriation ceiling is presented on page 35.

D. THE DEBT LIMIT

Section 13, Article VII of the Hawaii State Constitution places a debt limit on G.O. bonds that may be issued by the State. It has been determined that the total amount of principal and interest calculated on a) all bonds issued and outstanding; b) all bonds authorized and unissued; and c) all bonds proposed in the Supplemental Budget, including State guaranties, will not cause the debt limit to be exceeded at the time of each bond issuance.

The Declaration of Findings with respect to the G.O. bond debt limit is presented on page 45.